
Anticipated merger of the Technical Services Divisions of Scottish Courage Limited and Carlsberg-Tetley Brewing Limited

The OFT's decision on reference under section 33 given on 24 March 2004

PARTIES

Scottish Courage Limited (SCL) is a subsidiary of **Scottish & Newcastle plc** (S&N). S&N, through its subsidiaries, brews beer and wholesales beer and other beverages in the UK and elsewhere.

Carlsberg-Tetley Brewing Limited¹ (CTB) is a subsidiary of **Carlsberg-Tetley plc** (CT) and ultimately **Carlsberg Breweries A/S**. The Carlsberg Group's core business is the production, sale and distribution of beer but it is also active in the supply of soft drinks, wines and spirits.

Serviced Dispense Equipment Limited (SDEL) is a subsidiary of **Serviced Dispense Equipment (Holdings) Limited**, which is a new joint venture company owned by SCL (45 per cent), CTB (45 per cent), **Mordaunt and Foster Limited** (controlled by Mr Mike Foster and his wife) (5 per cent) and **Hallriver Limited** (controlled by Mr Nick Bryan) (5 per cent).

Innserve Limited (Innserve) is a newly formed services company, wholly owned by Mr Bryan (60 per cent) and Mr Foster (40 per cent).

TRANSACTION

For consideration of around £140 million, SDEL will:

- purchase the existing assets of SCL and CTB relating to equipment for the dispense of draught beer and cider and the dispense of wines at the premises of SCL's and CTB's on-trade customers;
- take over the parts of SCL's and CTB's businesses which (a) procure technical services equipment, and (b) provide technical services to install and maintain that equipment (a function to be sub-contracted to Innserve, see below); and

¹ Since the date of the decision, the parties have advised that Carlsberg-Tetley Brewing Limited has been renamed Carlsberg UK Limited and Carlsberg-Tetley plc has been renamed Carlsberg UK plc.

- provide that equipment and those technical services to SCL and CTB on a 10 year rolling contract basis at the premises of their on-trade customers.

SDEL will be the asset owner of the technical services equipment, and will sub-contract the provision of technical services in relation to that equipment to Innserve.²

The parties notified the transaction by way of a merger notice on 28 January 2004. This notice was withdrawn on 25 February 2004 and the OFT continued its assessment of the transaction as an informal submission. The 40-day administrative deadline will expire on 24 March 2004.

JURISDICTION

In the context of this merger, the parties overlap in the supply of technical services equipment and technical services. They are likely to supply more than 25 per cent of such equipment and services relating to the dispense of draught beer, cider and wine in Great Britain. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is likely to be met. The OFT therefore believes that it is or may be the case that a relevant merger situation will be created.

BACKGROUND

The OFT has previously considered the supply of technical services equipment and technical services to pubs. In 2001, the OFT examined the Four (originally Five) Brewers' Initiative (FBI)³ - which sets out procedures for the installation, alteration, modification and servicing of dispense equipment, ownership of such equipment and determining who has the legal responsibilities for compliance with statutory regulations - in the context of Chapter I of the Competition Act 1998.

Under the FBI, the 'principal supplier'⁴ at a pub installs all products lines for itself and any secondary supplier. The principal supplier provides technical services equipment and technical services for itself and all other brewers who supply beer to that outlet. In addition, the FBI provides that on a change of principal supplier, all of the generic technical services equipment owned by the outgoing supplier must be transferred to the ingoing supplier as it exists and at independently determined prices (the so-called 'must buy must sell' requirement).

The OFT did not consider that the FBI raised any significant competition issues.

² For the purposes of this decision, the arrangements between SDEL and Innserve will be referred to as the 'joint venture'.

³ The participants in the FBI are the brewers CT, SCL, Interbrew and Coors as well as HP Bulmer (now owned by S&N) and Matthew Clark (a drinks wholesaler and brand owner which is in the UK division of Constellation Brands Inc.)

⁴ The 'principal supplier' is either chosen by the retailer or, more commonly, is the brewer that supplies most of the beer to the outlet or has the greatest number of taps on the bar.

RELEVANT MARKETS

'Technical services equipment' consists of:

- dispense points, founts and T-bars;⁵
- product lines;
- line coolers;
- pressure systems and associated equipment; and
- cellar cooling equipment (although much of this is owned by the owner of the outlet).

'Technical services' consist of the installation and servicing (including repair, refurbishing and removal) of technical services equipment.

The joint venture will be involved in both (a) the purchase of technical services equipment for the dispense of draught beer, cider and wine,⁶ and (b) the supply of technical services equipment and technical services. These are considered in turn.

Purchase of technical services equipment

The parties estimate that the current annual value of purchases in the UK of technical services equipment for dispensing draught beer and cider is £75 million. The joint venture is likely to account for more than 25 per cent of technical services equipment purchases in the UK.

Some third parties expressed concerns that the joint venture would benefit from increased buyer power and hence an ability to extract lower prices from suppliers, leading to rationalisation (and possibly reduced choice to other buyers) in the manufacturing/distribution sector. However, there are a number of buyers of technical services equipment and it does not appear to be in the joint venture's interests to put its suppliers out of business. Given these facts, it is unlikely that the joint venture will significantly enhance upstream buyer power and result in a substantial loss of competition in the manufacture and distribution of technical equipment. In light of this, this sector is not considered further in this decision.

⁵ The parties included founts and T-bars in their definition of 'technical services equipment', on the basis that SDEL will be acquiring these from SCL and CTB. Generally, however, founts and T-bars are branded equipment and therefore, are not subject to the FBI, which only applies to generic equipment.

⁶ The parties state the technical services equipment for beer and cider and technical services required for beer, cider and wine are all very similar. However, the focus of the parties' submission is on equipment and services in relation to beer and cider; a format which is followed in this decision.

Supply of technical services equipment and technical services

Product market

The parties state that the supply of technical services have traditionally been viewed as an internal business function within each brewer, rather than a separate market. On this basis, brewers have typically supplied technical services equipment and technical services as a bundled product with beer and cider, charging a single composite price for the bundle.

More recently, several pub companies have invited tenders for the supply of technical services equipment and technical services separate from the supply of beer and cider, and some of those tenders have been won by independent providers of technical services. This would tend to indicate that the supply of technical services equipment and technical services is a distinct activity.

It might be possible to draw a distinction between the supply of technical services equipment and the supply of technical services, since the equipment can be installed by one supplier and serviced by a different provider. However, it is more common for the installing supplier to also provide technical services for that equipment, and a technical services provider will need to be able to supply at least some technical services equipment to carry out repairs, Therefore, this decision will consider them together.

The parties claim that the technical services equipment required for draught beer and cider is different to that required for soft drinks, but the technical services required to service and maintain both are very similar. Third party views supported the parties' claim regarding equipment, but the evidence is mixed on whether a provider of technical services for soft drinks or wine could quickly and at minimal cost start supplying technical services for beer and cider.

The parties submit that it is appropriate to consider supply of technical services equipment and technical services to all on-trade outlets⁷ rather than just pubs because 84 per cent of on-trade outlets contain cellar equipment. However, selling beer and cider is a core part of a pub's business compared to other on-trade outlets; consequently, they may have different requirements and may face different constraints. For example, pubs may require greater levels of service and more sophisticated technical equipment because of the larger range of products they offer. Clubs, hotels, bars and restaurants may be able to switch to supplying bottled beer and cider, but this is unlikely to be a viable option for a pub. In any case, no firm conclusion needs to be made on this issue here because it does not materially affect the competition assessment.

⁷ On-trade outlets include pubs, clubs, hotels, bars and restaurants.

Geographic market

Customers generally require their provider of technical services equipment and related services to be within easy reach of their pubs, which might suggest that the appropriate geographic scope is local or regional. However, the four major brewers⁸ supply beer and cider on a national basis and supply technical services on the same basis (although sub-contracts may be set up with regional or local technical services providers for more remote areas).

Conclusion on relevant markets

The appropriate frame of reference in this case appears to be the national supply of technical services equipment and technical services for draught beer and cider to all on-trade outlets.

HORIZONTAL ISSUES

Shares of supply

In the supply of beer in Great Britain, SCL and CTB are the largest and fourth largest brewers respectively with shares of [26-27 per cent] and [12-13 per cent], by volume, of the markets for brewing and on-trade beer distribution.

Of the estimated 133,300 on-trade outlets in Great Britain⁹, the parties submit that SCL is the principal brewer in [] outlets ([15-25 per cent]) and CTB in [] outlets ([5-15 per cent]).¹⁰ If these shares are taken as a proxy for the supply of technical services equipment and technical services, this would give the joint venture a share of supply of [25-35 per cent].

Of the estimated 55,765 pubs in Great Britain,¹¹ the parties submit that SCL is the principal brewer in around [] of these ([10-20 per cent]) and CTB in around [] ([5-15 per cent]). On this narrower basis, the joint venture would have a share of supply of [25-35 per cent].

Given that technical services equipment and technical services have traditionally been bundled with supply of beer and cider, separate share of supply figures are not readily available. Nevertheless, Table 1 below shows the parties' estimates of shares of supply of technical services equipment and technical services¹² to all on-trade outlets by volume. These estimates give the joint venture a [15-25 per cent] share, which is somewhat lower than the [25-35 per cent] when using principal supplier as a proxy. The parties submit that

⁸ S&N, CT, Coors and Interbrew.

⁹ Source: AC Nielsen, May 2002.

¹⁰ Coors estimates that it is the principal brewer in [] outlets ([5-15] per cent) and Interbrew estimates [] outlets ([] per cent).

¹¹ Source: AC Nielsen, July 2003.

¹² These figures are based upon the supply of technical services and the supply of technical services equipment incidental to the supply of those technical services.

this difference is due to the use of independent sub-contractors (other than SDEL) by the parties for many on-trade outlets.

Table 1 : Estimated share of supply of technical services equipment and technical services for draught beer and cider to all on-trade outlets

	Share of supply by volume(%)
SDEL *	[15-25%]
Coors	[5-15%]
Interbrew	[5-15%]
City Refrigeration	[5-15%]**
Total Cellar Systems	[1-10%]
Innflow	[1-10%]
Others***	[30-40%]
	100.0

- * *As a sub-contractor for SCL and CTB*
- ** *Includes [1-10%] for sub-contracted work*
- *** *Mainly small sub-contractors.*

The parties also noted that the joint venture's share of supply may be around [1-10 per cent] in the 'open market', being the supply of technical services equipment and technical services to pub companies or other suppliers/brewers for which specific consideration is received.

The parties have confirmed that they will continue to be members of the FBI and that the existing FBI provisions will continue to operate alongside the joint venture. This means that the FBI arrangements will continue unchanged as between SCL and CTB on the one hand, and other members of the FBI on the other. More specifically, there will be no change to the role of the principal supplier in the supply of technical services equipment and technical services; the charge made on FBI members; or the transfer of assets at FBI prices upon a change of principal supplier.

The only difference between the pre and post-merger situation will be when the principal supplier changes from SCL to CTB or vice versa. In this case there will be no switching of ownership of technical services equipment and service provider. This could result in lower switching costs for customers (i.e. on-trade outlets such as pubs) since they will not have to negotiate a new contract for technical services equipment and technical services.

The parties expect that SDEL's only customers for the foreseeable future will be SCL and CTB. However, there are no restrictions on SDEL acquiring technical services equipment from other brewers or drink suppliers and providing (through Innserve or another supplier¹³) technical services to other parties.

¹³ SDEL is not obliged to use Innserve as the provider of technical services in relation to other brewers or drink suppliers who may become SDEL customers in the future.

The parties submit that there are a number of competing suppliers of technical services equipment and technical services for beer and cider (and soft drinks). These include the other major brewers: Coors and Interbrew, City Refrigeration, Total Cellar Systems, regional brewers and small contractors. This proposition has generally been confirmed by third parties.

Barriers to entry

The parties believe that there are no significant barriers to the supply of technical services equipment and technical services. They point to several actual and potential suppliers on a nationwide basis, and a large number of suppliers at a regional level. The OFT's third party enquiries also identified a number of parties with plans to enter the market, notwithstanding the creation of this joint venture.

Estimates of the capital expenditure required to gain a 5 per cent share of the market ranged from £1 to £2 million for technical services only, and around £12 million for both technical services equipment and technical services. Estimates of the cost of training a technical services technician ranged from £5,000 to £30,000.

Overall, there do not appear to be any significant barriers to entry in this sector.

Buyer power

The joint venture's customers may include pubs, clubs, bars and restaurants. Some of these customers (e.g. pub companies) might have negotiating strength as a result of their size. This may enable them to resist price increases or achieve lower prices for the supply of technical services equipment and technical services. The recent example of Punch changing from principal supplier provision of technical services to independent supply and back to principal supplier again would tend to indicate that larger companies have the ability to switch. While smaller independent publicans may not have the same degree of negotiating strength as pub companies, they may nevertheless have the ability to switch to smaller local suppliers.

VERTICAL ISSUES

SCL and CTB will, through minority shareholdings, acquire the ability materially to influence the policy of SDE (Holdings) Limited and its subsidiary SDEL. Third parties raised a number of concerns arising from this vertical relationship. The main ones are discussed below.

Predation

One of the concerns raised by third parties was that the parent brewers of the joint venture might reduce the price charged for technical services below cost to remove independent suppliers from the market. It was argued that this reduced cost could be offset by increasing the price of beer and cider, increasing the price for technical services in future years or increasing the bundled price of beer/cider and technical services. However, the success of such a strategy depends on the ability of SCL and CTB to

sustainably raise prices for beer and cider (i.e. having market power) and there being significant barriers to entry for the supply of technical services - neither of which appear to be the case.

Enhanced potential for collusion

One third party raised the concern that technicians might be able to pass back information to the parent brewers about the sales of their competitors; another third party found this argument implausible.

The parties maintain that they have set up the joint venture in such a way as to limit potential anti-competitive concerns. For example, directors from SCL and CTB will be selected from their respective Operations functions, rather than Sales or Marketing and, in any board meeting where development plans for the brands of any other brewer are discussed, the SCL and CTB Directors will not be allowed to be present or participate. It appears unlikely that the merger would be able to provide the parties with the means to obtain information that would not similarly be available under the FBI.

THIRD PARTY VIEWS

The OFT sought the views of a wide range of third parties including equipment manufacturers and distributors, independent suppliers, brewers and both small and large customers. Overall, responses were mixed. Some thought that restructuring of the sector in this way may be more efficient than the current vertically integrated structure. Others thought that there might be an adverse effect on competition if further third parties such as brewers or pub companies joined the joint venture.

A large number of employees and sub-contractors from SCL and CTB contacted the OFT with concerns that the joint venture would adversely affect their employment and pension rights. Similar concerns were raised in a number of letters from several Members of Parliament. In accordance with its duty under s.57(2) of the Enterprise Act,¹⁴ the OFT wrote to the Secretary of State for Trade and Industry (SOS) advising that it had received representations that pension rights be added to the list of public interest issues at section 58(3) of the Act.

ASSESSMENT

The merger of SCL's and CTB's technical services divisions creates a joint venture company that will supply technical services equipment and technical services for draught beer and cider to on-trade outlets nationally.

¹⁴ Under S.57(2) of the Enterprise Act 2002, the OFT is under a duty to bring to the attention of the Secretary of State for Trade and Industry 'any representations about exercising his powers under s.58(3) which have been made to the OFT'. Section 58(3) empowers the Secretary of State to add a new public interest consideration or remove or amend an existing consideration.

The effect of the joint venture is to separate the supply of technical services equipment and technical services from the supply of beer and cider: traditionally, the two have been provided by brewers as a bundle. This separation follows recent developments in the industry which have seen a number of pub companies invite tenders for the sole supply of technical services to all their outlets.

The parties submit that the joint venture represents a natural evolution of the FBI (although it does not replace that initiative). They claim that, although the FBI is an improvement on the previous situation, its procedures are cumbersome, inefficient and time consuming. SCL and CTB believe that the merging of their technical services functions into a single dedicated service provider is likely to result in higher quality equipment installed, lower costs, higher standards of cellar management and improved product dispense.

Given the history of technical services equipment and technical services as a bundled product, shares of supply are not readily available. Depending on the method used, estimates of the joint venture's share of supply range from [15-25 per cent] to [25-35 per cent].¹⁵

The supply of technical services is not, in itself, a sector in which the brewers actively compete against each other for custom. The brewers compete to supply beer and cider to pubs and in so doing may need to take on the obligations of being the principal supplier to that pub. The requirements of doing so, however, are prescribed by the FBI which sets out the 'must buy-must sell' price at which technical services equipment is transferred and the cost at which the principal supplier will provide services to other suppliers to that pub.

In any case, the OFT's enquiries indicate that there are a number of actual and potential suppliers of technical services equipment and technical services, and the barriers to entry do not appear to be significant. Additionally, some of the joint venture's potential customers appear to possess countervailing buyer power, as evidenced by the recent switching of a major pub company between a brewer and an independent supplier of technical services.

The merger generated a large degree of interest from third parties with different views, who provided comments on a wide range of issues. However, the OFT was not provided with any convincing evidence to support any of the possible competition concerns identified.

Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the UK.

¹⁵ The parties noted that their share of supply in the 'open market' may be around [1-10 per cent] but for the purposes of this analysis the OFT focussed on the estimates in the higher range.

DECISION

This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.